

REPORT OF THE AUDITOR-GENERAL TO THE PROVINCIAL LEGISLATURE AND THE COUNCIL ON MOPANI DISTRICT MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the financial statements of the Mopani District Municipality, set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2012, the statements of financial performance, changes in net assets and cash flows for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting Officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA), the Division of Revenue Act, 2011 (Act No. 6 of 2011) (DORA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the *General Notice* issued in terms thereof and International Standards on Auditing. Because of the matters described in the Basis for disclaimer of opinion paragraphs, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Revenue

4. The district municipality in its capacity as principal has entered into an agency agreements with its five local municipalities for the provision of water and sewerage services as agents. There was no system of control over revenue from water services on which I could rely for the purpose of my audit, and there were no satisfactory alternative procedures that I could perform to obtain reasonable assurance that all revenues from water services was properly recorded.
5. Furthermore, I have identified unexplained differences amounting to R14 209 841 between confirmations of billings received from the local municipalities and the amounts recognised in the accounting records of the district municipality. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness and accuracy of water revenue of R153 662 393 (2011: R142 322 389).

Receivables

6. There was no system of control over receivables from water services on which I could rely for the purpose of my audit, and there were no satisfactory alternative procedures that I could perform to obtain reasonable assurance that all receivables from water services was accurately and completely recorded. The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to determine whether any adjustments to the accounts receivable balance of R290 714 049 (2011: R305 405 130) in the financial statements was necessary.

7. Included in receivables from exchange transactions balance is an amount of R13 116 895 due from an entity. However, the entity has confirmed that there are no amounts owed to the municipality. The municipality could not provide an explanation or supporting documentation for the difference of R13 116 895. The municipality's records did not permit the application of alternative audit procedures regarding the amount receivable from the entity. Consequently, I was unable to determine whether any adjustments to the accounts receivable balance of R297 736 842 (2011: 352 783 989) in the financial statements was necessary.
8. International Accounting Standards 39, *Financial Instruments, recognition and measurement*, requires an entity to assess at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets are impaired. The municipality did not assess whether there was objective evidence that receivables are impaired. The municipality provided for impairment on all debtors outstanding for more than 12 months. Further, the provision for doubtful debts includes debts owed by government departments and public entities. The municipality did not take into account different categories of debtors for the purposes of impairment.

Consequently, I was unable to determine whether any adjustments to the accounts receivable balance of R290 714 049 (2011: R305 405 130) in the financial statements was necessary.

Expenditure

9. The municipality could not provide sufficient appropriate audit evidence to support journal entries of R37 989 965 recorded in total expenditure. There were no satisfactory alternative procedures that I could perform to obtain reasonable assurance that all expenses were properly recorded. Consequently, I could not satisfy myself as to accuracy and occurrence of expenditure amounting to R37 989 965 and its related obligation and valuation on payables.

Trade and other payables

10. An amount of R8 466 220 related to water services was confirmed as payable by a local municipality. However, this amount is not included in trade and other payables balance of R364 343 145 as disclosed in note 14 to the financial statements. The municipality could not provide sufficient appropriate audit evidence to confirm that the amount noted above is recorded in the accounting records. The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to determine whether any adjustment relating to accounts payable in the financial statements was necessary.
11. As stated in note 14 to the financial statements, is an amount of R4 849 275 is received in advance from consumers. The municipality could not provide me with sufficient appropriate audit evidence to support this balance. The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to determine whether any adjustment relating to payments received in advance in the financial statements was necessary.
12. As disclosed in note 14 to the financial statements, an amount of R22 870 319 pertains to leave pay. The amount was not split into long-term and short-term obligation to indicate the difference in uncertainties in the amounts and timing of the pay out of the leave pay. The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to determine whether any adjustment relating to the accounts payable and provision balances in the financial statements was necessary.

Property, plant and equipment / movable and immovable assets

13. The municipality did not review the residual values and useful lives of assets on an annual basis as required by Standard of GRAP, GRAP 17, *Property, plant and equipment* (PPE). The municipality's records did not permit the application of alternative audit procedures. Consequently, I could not satisfy myself as to the appropriate valuation of the PPE balance of R1 853 265 718.
14. As stated in note 2 to the financial statements, the accumulated depreciation on PPE amounts to R437 100 272. However, a difference of R24 499 323 was noted between the accumulated depreciation balance as per note 2 to the financial statements and the accumulated depreciation balance recalculated based on the underlying records. The entity could not provide an explanation or supporting documentation for the difference noted above. The municipality's records did not permit the application of alternative audit procedures. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the valuation and allocation of PPE balance of R1 853 265 718.

Irregular expenditure

15. No system was in place for the identification and recognition of irregular expenditure and there were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all irregular expenditure was properly recorded. Payments amounting to R124 365 606 were made in contravention of the supply chain management regulations. The amount was not included in irregular expenditure, disclosed in note 42 to the financial statements. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of irregular expenditure as disclosed in note 42 to the financial statements amounting to R152 470 478.

Unauthorised expenditure

16. Expenditure amounting to R112 729 680 were incurred in excess of the approved budget and in contravention to MFMA. The amount was not included in unauthorised expenditure disclosed in note 40 to the financial statements. I have further noted that there is a material amount of unspent conditional grants at year end which are not sufficiently covered by cash and investments. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of unauthorised expenditure as disclosed in note 40 to the financial statements amounting to R209 045 577.

Contingent Liabilities

17. The municipality disclosed an amount of R32 987 233 in respect of contingent liabilities in note 37 to the financial statements. The municipality could not provide supporting documentation for this amount. Further, I have identified unexplained differences between the confirmations received from third parties and the amounts disclosed in the financial statements. The municipality's records did not permit the application of alternative audit procedures. Consequently, I could not satisfy myself as to accuracy and completeness of the amount of contingencies disclosed in note 37 to the financial statements amounting to R32 787 233.

Cash flow statement

18. Presentation of a cash flow statement, summarising the municipality's operating, investing and financing activities, is required by SA standards of GRAP 2, *Cash Flow statements*. An amount of R31 636 617 relating to non-cash flow items have been disclosed in the cash flow statements. The municipality could not provide an explanation for including non-cash items in the cash flow statements. The municipality's records did not permit the application of alternative audit procedures. Consequently, I could not satisfy myself as to accuracy and completeness of the net cash flows from investing activities disclosed in the cash flow statements.

Accumulated surplus

19. The comparative balance of restated accumulated surplus of R1 811 725 365 as disclosed in the Statement of Changes in Net Assets does not agree to the recalculated balance of R1 872 942 082 per the underlying accounting records. The entity could not provide an explanation or supporting documentation for the difference of R61 216 717 between the financial statements and the underlying accounting records. Due to the difference of R61 216 717 as noted above, the current year closing accumulated surplus of R1 818 040 978, per the Statement of Changes in Net Assets also does not agree to the balance of R1 879 257 695 per the underlying records. Consequently, I could not satisfy myself as to accuracy and completeness of statement of changes in net assets.

Presentation and disclosure of financial statements

20. SA Standards of GRAP 1, *Presentation of Financial Statements*, paragraph .19 (b) and (c) requires that financial statements should provide information, including accounting policies, presented in a manner which is relevant, reliable, comparable and understandable. Further it states that, additional disclosures should be made when compliance with the specific requirements in Standards of GRAP are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance. The following non compliances with regard to GRAP 1 were identified which were inadequate for the fair presentation of the financial statements:
- International Financial Reporting Standards, IFRS 7 disclosures with regard to financial risk management was not disclosed.
 - Various SA Standards of GRAP 1 non compliances in the accounting policies with regard to the accounting treatment of balances disclosed in the financial statements.
 - The note to the financial statements on inventory was not compliant with the disclosures requirements of SA Standards of GRAP 12, *Inventory*, paragraph 47.
 - An impairment of R27 113 084 has been disclosed in Note 6 to financial statements, however, the narration pertaining to this impairment have not been disclosed.

Distribution losses

21. Section 125 (2) (d) (i) of the MFMA requires that the notes to the annual financial statements of a municipality must disclose the particulars of any material losses. Contrary to these requirements, the municipality did not disclose the water distribution losses as required by the MFMA.

Opinion

22. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matters

I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

23. As disclosed in note 39 to the financial statements, the corresponding figures for 2011 have been restated as a result of an error discovered during 2012 in the financial statements of the entity, and for the year ended, 2011

Additional matter

I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited supplementary schedules

24. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereof.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

25. In accordance with the PAA and the *General Notice* issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

26. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages ... to ... of the annual report.
27. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury annual reporting principles and whether the reported performance is consistent with the planned objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the *National Treasury Framework for managing programme performance information*.
28. The reliability of the information in respect of the selected objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

The material findings are as follows:

Usefulness of information

Presentation

Measures taken to improve performance not disclosed

29. Improvement measures in the annual performance report for a total of 100% of the planned targets not achieved were not disclosed as required by section 46 of the MSA. This was due to inadequate internal policies and procedures over the processes pertaining to the reporting of performance information.

Consistency

Reported targets not consistent with planned targets

30. The Municipal Systems Act 2000 (Act No. 32 of 2000), (MSA), section 41(c) for municipalities requires that the integrated development plan should form the basis for the annual report, therefore requiring the consistency of targets, between planning and reporting documents. A total of 29% of the reported targets are not consistent with the targets as per the approved integrated development plan. This is due to the lack of review and adequate monitoring of planned targets against actual achieved targets by management and internal audit.

Measurability

Performance indicators not verifiable

31. The National Treasury *Framework for managing programme performance information* (FMPPI) requires that it must be possible to validate the processes and systems that produce the indicator. A total of 42% of the indicators relevant to provide safe and clean water and develop and maintain infrastructure were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to the lack of key controls in the relevant systems of collection, collation, verification and storage of actual performance information.

Performance targets are not specific

32. The National Treasury FMPPI requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 33% of the targets relevant to provide safe and clean water and develop and maintain infrastructure were not specific in clearly identifying the nature and the required level of performance. This was due to the fact management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.

Reliability of information

Validity Accuracy and Completeness

Reported indicators not supported by sufficient appropriate evidence (validity, accuracy and completeness)

33. The National Treasury *Framework for managing programme performance information* (FMPPI) requires that documentation addressing the systems and processes for identifying, collecting, collating, verifying and storing information be properly maintained. The municipality could not provide sufficient appropriate evidence to support the actual performance levels for the selected development priorities.

Compliance with laws and regulations

34. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the *General Notice* issued in terms of the PAA are as follows:

Annual financial statements, performance and annual report

35. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected and the supporting records could not be provided subsequently, which resulted in the financial statements receiving a disclaimer audit opinion.
36. The annual performance report for the year under review does not include a comparison with the previous financial year and measures taken to improve performance, as required by section 46 (1)(b)(c) of the MSA.

Human Resource management and compensation

37. The competencies of financial and supply chain management officials were not assessed promptly in order to identify and address gaps in competency levels as required by the Municipal Regulations on Minimum Competency Levels regulation 13.
38. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury as required by the Municipal Regulations on Minimum Competency Levels reg14(2)(a).
39. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies as required by the Municipal Regulations on Minimum Competency Levels reg14(2)(b).

Expenditure management

40. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
41. An effective system of expenditure control, including procedures for the approval, authorisation, withdrawal and payment of funds, was not in place as required by section 65(2)(a) of the MFMA.
42. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred, accounted for creditors, accounted for payments made, as required by section 65(2)(b) of the MFMA.
43. The accounting officer did not take effective steps to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
44. Irregular, fruitless and wasteful expenditure was not recovered from the liable person, as required by section 32(2) of the MFMA.

Revenue management

45. An adequate management, accounting and information system was not in place which recognised revenue when it was earned, accounted for debtors and accounted for receipts of revenue, as required by section 64(2)(e) of the MFMA.
46. Revenue due to the municipality was not calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.

Procurement and contract management

47. Quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy in contravention of SCM regulation 16(b) and 17(b).
48. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
49. Contracts were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
50. Awards were made to providers who are persons in service of other state institutions or whose directors/ principal shareholders are persons in service of other state institutions, in contravention of SCM regulations 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).
51. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).
52. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act and CIDB regulation 18.

Asset management

53. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which accounts for the assets of the municipality as required by section 63(2)(a) of the MFMA.

VAT

54. VAT on water related transactions were incorrectly accounted for in the records of the local municipalities and therefore non-compliance to section 54 of the Value Added Tax Act.

INTERNAL CONTROL

55. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for disclaimer of opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

56. Management does not always appropriately provide the required supervision and review over operations to ensure that the municipality complies with all laws and regulations and appoint the necessary skilled staff members. Action plans were developed, however, they were not fully implemented, hence the recurrence of findings identified in the prior year with regard to asset management and water related transactions not adequately monitored and reconciled frequently

Financial and performance management

57. Lack of technical knowledge and high reliance on consultants with regard to new accounting standards and legislation in most of the directorates in the municipality to adequately perform their functions. These relate to functions such as regular confirmation, existence and reconciliation of assets and water related transactions and implementing accounting guidelines and standards and adhering to stipulations of laws and regulations. This has resulted in the disclaimer opinion received on the submitted financial statements and reported performance on set targets.

Governance

58. Management ineffectiveness in implementing recommendations from internal and external audit did not enable the audit committee to promote accountability and service delivery through evaluating and monitoring responses to risks and providing oversight over the effectiveness of the internal control environment, including financial and performance reporting and compliance with laws and regulations.

Auditor General
Polokwane

30 November 2012



AUDITOR - GENERAL
SOUTH AFRICA

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